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ABSTRACT

Recent studies of retirement have recognized the importance of pension plans and social security on the retirement decisions. A pension system that is neutral with respect to the timing of benefits encourages or discourages the acceptance of these benefits and subsequent job separation at any particular age only to the extent that any asset affects such a decision. A pension system is not neutral when the value of either pensions or social security changes the timing of benefit acceptance. Only recently has the degree to which pension plans and social security induce retirement been considered. Burkhauser and Quinn (1980) provide the most detailed study of the relationship between the present social security and employer pension systems and the work behavior of older men. Results confirm that while change in mandatory retirement rules will increase the labor supply of older men, the increase is significantly smaller than would be the case in the presence of actuarially neutral pensions and social secrity. Better information on pension systems and their effect on individual behavior could be arrived at if the perceived future health, inflation, post-retirement work, and actual and expected retirement behavior would also be considered. (YLB)

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RETIREMENT DECISIONS: INCENTIVES AND CONSTRAINTS

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I. Nature and Significance of the Subissue

Retirement to some, genuinely means the "golden years" -- full-time leisure for indulging in travel, hobbies, and other pastimes that were previously limited by the constraints of employment. For a considerable segment of older citizens, however, the decision to retire represents an uneasy financial compromise, marked by the onset of boredom, anxiety, and the mental strain of feeling suddenly useless to society. The increasing commitment of both private and public funds to our present retirement system therefore makes it imperative that the effects of this system on an individual's decision to retire are fully understood.

II. Broad Goals and Objectives

The timing of retirement from a single job or from all market work will vary across individuals. Such variations may be caused by different tastes and attitudes about work, as well as by differing health conditions and family responsibilities. But it also depends on economic variables which make the choices between continued work or retirement more or less appealing.

The decline in work by older men represents a significant evolution in the American economy. In 1948, one-half of all men over 65 were still in the labor force; today fewer than one in five are at work. Since 1961, the proportion of employed men aged 62-64 has fallen from eight in ten to six in ten. These figures in themselves do not signal a problem. Indeed, our society places a high value on leisure and views it as a just reward for time spent working. However if the figures reflect a response to a method of providing retirement benefits which penalized work (i.e., age bias pension plans, mandatory retirement pensions), then the social value of such a system must be called into question. This is the case, not only because

it may be inducing workers out of the labor force who otherwise would have continued in productive work; but also because once such people leave work, it may be difficult for them to return even when economic conditions make them more anxious to do so.

Recent studies of retirement have recognized the importance of pension plans and social security on the retirement decision. The very existence of a pension plan which can be taken at a given age will, of course, provide workers with the option of leaving their job and accepting benefits at that age. For workers who do not fully anticipate these benefits or who face imperfect capital markets, the income or wealth impact of such a pension increases the likelihood of pension acceptance and job separation at that age. Few would object to this affect of pension plans on work. Furthermore, if those who continued working were rewarded with increased yearly benefits which fully compensated them for not immediately taking a pension, only individual tastes and preferences would enter into such a choice. This type of pension system would be neutral with respect to the timing of benefits. It would encourage or discourage the acceptance of these benefits and subsequent job separation at any particular age only to the extent that any asset affects such a decision.

However, a pension system is not neutral when the value of either pensions or social security changes with the timing of benefit acceptance. This can be best understood by thinking of benefits from a pension plan or social security as coming from an annuity whose lifetime value is the discounted sum of its monthly payments. This lifetime or asset value is sensitive to the age at which benefits begin. If monthly benefits increase sufficiently to increase the lifetime annuitized value of the plan even when its acceptance is delayed, then the plan rewards additional work and provides an incentive to continued work similar to an increase in wages.

But if the asset value falls when benefits are delayed, it punishes future work and encourages retirement.

III. Major Accomplishments

The degree to which pension plans and social security induce retirement in this way has only recently been considered. Initially, most empirical labor supply studies concentrated on the effect of social security on the work effort of older workers (see: Boskin (1977), Boskin and Hurd (1978), Blinder, Gordon and Wise (1978), and Burkhauser (1980). Burkhauser (1979) changed the scope of these studies by emphasizing and testing the importance of private pensions on work behavior of older workers.[1]

Quinn (1977) used data from the Retirement History Survey (RHS) to study the effects of both social security and pension on labor supply. More recently, Hall and Johnson (1980) and Burkhauser and Quinn (1980) have empirically tested models which utilized more detailed data to analyze the labor supply effects on individual workers of both social security and pension systems. Anderson, Clark and Johnson (1980) use the same data to study the retirement decision but incorporate it within a household model. This enables the behavior of both an aged worker and spouse to be incorporated into the analysis.

Traditionally, the decision to work has been within a single period framework with no consideration of the multiperiod nature of both social security and private pensions. But unless a pension plan provides no actuarial adjustment for postponed acceptance of benefits, a single period model cannot distinguish between initially lost benefits and permanent losses. This point is not considered in the theoretical sections of Boskin (1977) or Quinn (1977) and explicitly assumed away in Boskin and Hurd (1978).

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[1]Earlier work on the labor supply effect of social security and private pensions includes: Barfield and Morgan (1969), Reno (1971), Schwab (1974), U. S. DHEW (1976a), U. S. DHEW (1976).

Hall and Johnson (1980) acknowledge the importance of multiperiod models but present none. Their empirical estimate of the value of a private pension is a single-year unadjusted flow value.

Burkhauser (1979), using data on the United Auto Workers pension system, shows that it is not the size of annual benefits received each year but the change in the present value of the entire potential stream of benefits that is theoretically and empirically important. Burkhauser and Turner (1978) discuss this point with respect to the social security system's effect on younger workers, and Burkhauser (1980) tests the relevance of an asset maximization model on the decision to accept early social security benefits.

An asset value is a more complex value to estimate than is a single-year flow value since it requires detailed information on the scheme used to provide benefits. Burkhauser (1980) made this calculation using actual data from social security records. Boskin (1977) and Boskin and Hurd (1978) relied on a simulated value to estimate their single-year benefit and Quinn (1977) and Hall and Johnson (1980) rely on a simple dummy variable of eligibility.

Burkhauser and Quinn (1980) provide the most detailed study of the relationship between our present social security and employer pension systems and the work behavior of older men. This paper disentangles the effect of mandatory retirement rules from that of actuarially biased social security and pension benefits to predict effects of the 1978 Amendments to the Age Discrimination in Employment Act on work effort. Building on work by Wertheimer and Zedlewski (1980), the paper uses actual social security records as well as four waves of the RHS (1969 through 1975) to

obtain estimates of these values. The labor supply behavior of those not subject to mandatory retirement over a given period is first obtained and then these estimates are used to predict the behavior of those who were subject to mandatory retirement. By use of a residual technique, they estimate the maximum effect of mandatory retirement rules on job exit. The results confirm that while the change in mandatory retirement rules will increase the labor supply of older men, the increase is significantly smaller than would be the case in the presence of actuarially neutral pensions and social security.

IV. Barriers to Progress

Several avenues of research lie ahead. The asset value and changes in that value for pensions and social security are complex measures. Because social security rules are well known and several data files contain actual social security earnings information, it has been possible to estimate individual asset values with a great degree of accuracy. This has not been the case for pension plans. Therefore, to this point strong assumptions concerning the characteristics of various pension plans have been made.

V. Special Opportunities

Recent DOL-BLS surveys have detailed information on private pension plans, as well as other fringe benefits, by industry. The merging of this data to individual worker records would lead to much better information on pension systems and their affect on individual behavior.

Even if this refined data were available, two aspects of the asset value measure still would require additional refinement. Because benefits continue into the future, worker decisions concerning acceptance are based on their individual estimates of life expectancy and their assumptions about inflation (in the case of social security, benefits are tied to the inflation rate and this is less of a concern).

With respect to this first uncertainty, even holding present health conditions constant, the shorter future life is expected to be, the less likely a person is to continue working. How important perceived future health is on current retirement decisions has not been empirically tested. With respect to inflation, Clark and Johnson (1980) has simulated the affect of alternative inflation rates on fixed benefit pension plans and shows how critically inflation affects pension wealth. But no empirical studies of the behavioral effect of inflation on retirement decisions have been reported.

Another area which has received scant attention is post-retirement work. What at first seems to be a contradiction in terms reflects the lack of a consensus on what is meant by "retirement". Empirical measures of retirement have ranged from complete exit from the labor force to partial reduction in hours, to simply exit from a given job. Gustafson (1981) has looked at these different measures but little research has been done on the labor force behavior of those who retire in one period but later return to work. Burkhauser and Quinn (1980) found that about 10 percent of their sample of workers aged 64-66 who leave their job remain in the labor force. But they were not able to explain this behavior empirically. They also did not look at the experience of these retired workers in other periods.

Each of these proposed study areas continue to emphasize empirical analysis of actual behavior. A much less explored aspect of retirement is the relationship between expectations concerning retirement and actual behavior. Reimers (1977) in her unpublished dissertation does attempt to compare actual and expected retirement behavior. Her data--the National

Longitudinal Survey--however was not very detailed and allowed her to make only a cursory evaluation of this relationship. A first task along these lines would be to develop and test a model of retirement expectations, then determine the degree these plans are reliable proxies for actual behavior. One test of this reliability is to compare regression equations which predict job exit or market exit of older workers using actual behavior as the dependent variable with the same equations using expected behavior.

While expectations should be related to actual behavior, they are likely to diverge to some degree. A major task of such a study would be to determine the degree to which this divergence is caused by unexpected changes in personal characteristics, unexpected changes in economic conditions, or simply better information. The most obvious unexpected change in a personal characteristic would be health. The longitudinal nature of the RHS makes such analysis possible. Unexpected changes in economic conditions would include changes in the inflation rate or unemployment. With respect to better information, a key determinant of changes in plans may be revised estimates of the amount of retirement income for which an individual is eligible. These estimates can change because an initial impression was incorrect, or because the benefit amounts change with subsequent years of work.

VI. Recommendations

The research questions posed above will provide better information on how potential retirees take into consideration the incentives and constraints of our current retirement system in formulating retirement plans and the extent to which economic forces alter these plans and affect actual behavior. Such information is vital to estimate the behavioral

responses to current public policy proposals which would alter the current system. For example:

a. What would be the work response to changes in the social security earning test? Or more generally, what would be the work response to legislation which required all pension plans to be "neutral" with respect to postponed benefit payments?

b. How important would the proposed banning of mandatory retirement at any age be on work and what type of employer responses would this provoke?

c. What would be the effect of postponing eligibility for social security benefits to age 68?

d. What would proposed "women's issues" reform of social security do to family retirement patterns?

e. How long a transition period is necessary to avoid a serious disruption in the retirement planning of younger workers?

f. How serious a disruption has inflation been to our current retirement system and what changes in the system are necessary?

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